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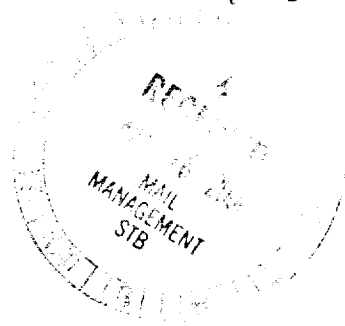

BEFORE THE

SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub. No. 1)

COMMENTS OF

HOUSATONIC RAILROAD COMPANY, INC.

MAY 16, 2000

Edward J. Rodriguez
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ORIGINAL

BEFORE THE

SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub. No. 1)

COMMENTS OF

HOUSATONIC RAILROAD COMPANY, INC.

IDENTIFICATION OF PARTY

Housatonic Railroad Company, Inc. is a Class III railroad operating in the states of Connecticut, Massachusetts and New York. It was a party of record in F.D. 33388, the acquisition of Consolidated Rail Corporation by Norfolk Southern Railway Company and CSX Transportation Company. As such, it acquired a first hand familiarity with the STB process for the approval of major rail consolidations and an appreciation of many of the short line issues which are likely to arise in any major rail consolidation proceeding.

Housatonic Railroad offers this preliminary response to the Surface Transportation Board's solicitation of public comments on major rail consolidation issues. Housatonic Railroad limits its comments to issues of particular importance to Class II and Class III railroads and expects to supplement its comments herein by filing a reply after it has reviewed comments of other participants.

Housatonic Railroad submits these comments because it is interested in the public policy affecting the rail transportation system in the United States. These comments are not intended to describe and should not be construed as describing or relating in any way to the relationship between Housatonic Railroad and its class I railroad connection.

INTRODUCTION

The restructuring of the United States railroad industry began with the bankruptcy and reorganization of many of the Eastern railroads, was continued by the formation of Conrail and thereafter facilitated by the Staggers Act in 1980. The recent major rail consolidations together with the proposed and anticipated further consolidations should complete the restructuring process.

One of the consequences of the process has been a rationalization of railroad infrastructure. As a result of the rationalization process, many rail lines were permanently removed from rail service while a small percentage was rail banked for future rail service. Many of the rationalized properties were sold to new or existing short line carriers. In the last 20 years, the number of Class III operators has increased dramatically to more than 500 and many Class II and Class III carriers have expanded their properties and operating systems. During that period, Class II and Class III carriers have become a vital and important component of the national transportation network. Similar developments have occurred in Canada. Over the same period of time, Class I carriers have tended to focus on their role as long haul carriers rather than as local service providers. Recent rail consolidations have continued that trend.

As the Surface Transportation Board reviews existing rail consolidation procedures, and prepares to issue new regulations, it must and will be considering the overall effects of particular transactions upon the entire rail transportation network. The STB conclusion that it must take into account downstream effects of transactions is fully warranted by recent developments in the transportation network as well as by its congressional mandate. As a part of that review, the Surface Transportation Board should reexamine the essential role which Class II and Class III carriers (hereinafter collectively referred to as "short lines") play in the transportation network and should adopt regulations and procedures which address Class II and Class III issues.

RELATIONSHIP OF CLASS I RAILROADS TO SHORT LINES

The relationship between Class I carriers and short line carriers is complicated and in some ways contradictory.

Short line railroads differ greatly in their size. Nevertheless, they are all essentially local service providers. While some short lines have local traffic or interchange with other short lines, most short lines interchange the bulk of their traffic with class I railroads.

Class I railroads provide two distinct and different types of transportation services. They are, first and foremost, the long haul "Network Providers". As such, they play a distinctive and unique role in the rail transportation system. In addition, they also provide local service and in that capacity serve the same function as short lines ("Local Service Providers"). With respect to traffic which it neither originates nor terminates, a Class I railroad is an overhead carrier and Network Provider. With respect to traffic originating (or terminating) on the Class I and terminating (or originating) on a short line, it is a Network Provider to the short line and a Local Service Provider to its on-line customer.

As a Network Provider, the Class I is a supplier, or wholesaler, to the short line, and a partner in the provision of rail transportation services. As a Local Service Provider, the Class I is often a competitor of the short line for the same business.

For the majority of short lines which have only one class I connection, the monopoly power which can be exerted by the Class I railroad is significant. It exists in the form of a bottleneck which permits the Class I to control rates and routes. As both a competitor of the short line and its only access to the general transportation network, the Class I can engage in significant anti-competitive conduct to the significant disadvantage of short lines and their customers. Yet the short line must work with the Class I as a partner in the development of transportation business.

The peculiar and conflicting aspects of the Class I/short line relationship require review by the STB and the development of policies and procedures to ensure a fair, efficient, and non-discriminatory transportation system for short lines and their customers. The policies should be designed to ensure that Class I railroads do not use their monopoly power as Network Service Providers to compete unfairly with short lines or to discriminate against them with respect to rates or service.

EFFICIENCY GOALS AND COMPETITION

A primary goal of the Rail Transportation Policy of the United States and of the Surface Transportation Board is to promote an efficient rail transportation system. The efficiency objective has many components. Central among them is the creation of a seamless transportation network and the promotion, whenever possible, of a competitive rail transportation environment. These two components of efficiency are inter-related.

A seamless system is one in which traffic is routed from origin to destination by the most efficient means with the intermediate carriers being essentially invisible to the shipper. This requires efficient access by short lines to the long haul transportation network provided by the Class I railroads. A competitive transportation environment also requires that, to the extent possible, rail customers have access to competitive rail options and routing alternatives.

To fulfill their role as efficient Local Service Providers, short line railroads must be able to provide their customers with seamless service and non-discriminatory, competitive access whenever possible. This is best achieved by extending competitive short line access to both Class I and other short line railroads. A major rail consolidation proceeding presents a unique opportunity to extend competitive access beyond that which was available prior to the transaction.

In the past, the STB has focused on maintaining existing competition in major rail consolidation procedures, to the extent that it was possible in the context of those proceedings. The STB has rarely focused on increasing competition beyond that which existed before the transaction. However, since the enactment of the Staggers Act, the number of class I rail carriers has decreased from more than thirty to seven. Of the seven class I carriers, four dominate the industry. Many areas of the country are now captive to a single class I railroad. That concentration of market power resulted from the restructuring of the rail transportation industry, which continues to occur, and demands that regulators take appropriate measures to promote and expand competition.

SEPARATION OF NETWORK AND LOCAL SERVICE FUNCTIONS

The current state of the industry requires a new way of examining not only the downstream effects of merger and consolidation transactions, but the effects of a proposed transaction on short line carriers and their customers. The current situation has analogies in the recent history of telecommunication and electric utility regulation and deregulation.

As indicated above, class I railroads are both Network Providers and Local Service Providers. To a certain extent, both the electric utility industry and the telephone industry have been required to address a conflict of functions by requiring their separation or divestiture. Divestiture of local service by Class I carriers is neither necessary nor desirable to accomplish the competitive and seamless service objectives.[1] While telecommunications and electric distribution were once seen as natural monopolies, technological advances have made them less so. The railroad industry, however, retains many of the attributes commonly associated with natural monopolies. Given the barriers to entry, it appears that they will always be monopolies.

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[1] A mandatory divestiture by Class I railroads of local service would, in many cases, necessarily involve operation by local service providers over local main line track of Class I Network Providers. In many cases, such operation would have undesirable service and safety implications. Furthermore, as indicated below, except in extreme cases in connection with consolidation transactions, mandatory divestiture of branch lines by Network Providers is not necessary to accomplish the competition and seamless objectives which would be a part of the rail transportation network. Branch line service is a valuable asset of Class I's and, in cases of high density branch lines, Class I's have an essential interest in insuring a continued and reliable flow of traffic on and off the line. However, the regulatory structure should continue to encourage voluntary divestiture transactions by Class I's to Class II and Class III operators.

The competitive balance can best be achieved by requiring Class I Network Providers to price Network and Local services separately and by prohibiting them from using their network monopoly to extract monopoly profits. Class I railroads should be required to provide wholesale network services to short line carriers at prices that reflect the marginal cost of providing the service plus a reasonable return to the Class I. Pricing of overhead services between a short line and another carrier should not be used by the Network Provider to disadvantage one route compared to another nor to attempt to profit from Local Services provided by the short line.

The reduction in the number of class I rail carriers and the consequent concentration of market power should induce the STB to focus on the expansion of competition in long haul Network Services.

CONCLUSION

The Surface Transportation Board should use its authority over major rail consolidations to promote and enhance competition and a seamless rail transportation network by increasing competitive access of short lines to other rail carrier connections and by requiring separate, competitive pricing of overhead services by Network Providers to short line carriers.

Respectfully submitted,

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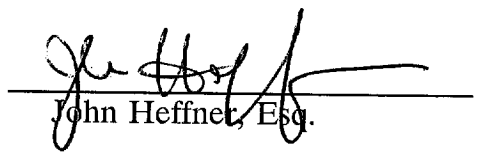
Certificate of Service

I hereby certify that a copy of the foregoing Comments has been served upon all parties of record.



John Heffner, Esq.